UNITED
NATIONS

TD

United Nations Conference on Trade and Development

Distr.
GENERAL

TD/B/WG.3/2
29 October 1992

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Ad Hoc Working Group on Comparative
Experiences with Privatization
First session
Geneva, 30 November 1992
Item 3 of the provisional agenda

ESTABLISHMENT OF THE WORK PROGRAMME OF THE WORKING GROUP

Issues for consideration in the establishment of the work programme

Note by the UNCTAD secretariat

CONTENTS

		Paragraphs
	Introduction	1 - 4
I.	Objectives of privatization	5 - 8
II.	Design and implementation of privatization programmes	9 - 14
III.	Some selected issues of privatization	15 - 21
IV.	Organization of work	22 - 25

GE.92-52786 (E)

INTRODUCTION

1. On 7 May 1992, the Trade and Development Board adopted the terms of reference of the Ad Hoc Working Group on Comparative Experiences with Privatization (decision 398 (XXXVIII, annex C). Under those terms of reference, the Working Group should review the experiences of countries with privatization, consider medium and long-term objectives of privatization processes, consider factors pertinent to the design and implementation of privatization programmes, elaborate, as possible guidelines for policy-makers, basic elements for consideration in formulating privatization programmes and plans, and serve as a forum for the presentation of national programmes and plans, for privatization, as well as for the exchange and dissemination of relevant information.

2. In order to facilitate the task of the Working Group in formulating its work programme and setting priorities, this note identifies the main issues which could be addressed in comparing experiences with privatization.

3. The terms of reference of the Working Group suggest several possible components in the work programme:

(a) Definition and choice of the objectives of privatization;

(b) Factors pertinent to the design and implementation of privatization programmes;

(c) Some selected issues of privatization.

4. The main issues that may be considered in examining each of these components are indicated below. In each case, a brief outline of the issues is given, followed by a set of related questions which may help experts to organize their contributions in the light of their own expertize and experiences. The exchange of national experiences is a particularly important aspect of the work of the Working Group. The note concludes with some observations on the organization of work.

I. OBJECTIVES OF PRIVATIZATION

5. Privatization is a key element in an overall strategy for the restructuring or reform of public enterprises, and of private sector development. It is undertaken for many reasons and involves various methods, including transfer of ownership of an enterprise to the private sector or of its assets following liquidation, partial privatization through sale of minority shares, and privatization of management through management contracts, leasing and concessions. Among the goals often cited are: enhancement of enterprise performance, of competition and of the efficiency of resource allocation; raising of fiscal revenue; generation of private investment, including foreign capital; reduction of financial and administrative burdens on the State (or redefinition and reduction of the role of the State in the economy); rationalization or restructuring of particular economic sectors; development of

the private sector and the domestic capital markets; creation of wider share ownership ("popular capitalism"); and employment creation through increased investment and growth. Governments have also undertaken privatization programmes in the context of structural adjustment or economic liberalization programmes.

6. As the goals of privatization may conflict, efforts to accomplish incompatible objectives at the same time may result in none being achieved. Widely dispersed share ownership may be an important consideration but efficiency may be compromised if such ownership interferes with effective corporate governance. The task of the Government is to clarify and balance conflicting objectives, distinguishing between primary objectives like efficiency enhancement and shorter-term considerations such as revenue raising. The task of the Government is also to choose the method most appropriate to the objective to be pursued, taking into account the factors involved (see para. 10).

7. Privatization in the countries undergoing the process of transition to a market economy differs greatly from other situations. It involves a more massive and complex undertaking in a context where concepts of market prices, property, ownership, title and contract are still new and where institution building in legal, commercial and financial spheres is still at an early stage. The aims are also different, being more overtly socio-political than elsewhere, with privatization being viewed not merely as a tool to enhance efficiency but as the principal instrument of the transformation process itself.

8. In the light of the above, the questions that may be addressed include:

(a) What factors have led to decisions to privatize? How has the choice of objectives and privatization methods been determined? To what extent have they addressed the problems to be solved?

(b) What have been the medium and long-term objectives of privatization programmes? What factors and conditions have facilitated or impeded their effective implementation?

(c) What has been the relationship of structural adjustment or economic liberalization programmes to the performance of privatization programmes?

(d) Under what circumstances are regulatory reforms to promote competition or the reform or rationalization of public enterprises an appropriate alternative to privatization?

II. DESIGN AND IMPLEMENTATION OF PRIVATIZATION PROGRAMMES

9. The experiences and results of privatization are mixed. As regards the scale and pace of privatization, it is still modest in most developing countries, with more progress being registered in the larger or high- or medium-income developing countries than in the smaller or low-income developing countries, and progress being less advanced than anticipated in the countries undergoing the process of transition to a market economy. As regards the enterprises

privatized, there has been faster progress for small and medium-sized enterprises in competitive sectors than for large-scale enterprises in non-competitive sectors. However, the World Bank has reported that the last two years have seen an increase not only in the number of large public enterprises being sold or readied for sale, but also in the number of countries undertaking privatization, as well as a pick-up in the pace of sales. 1/

10. Policy choices concerning the scale and pace of privatization, the enterprises to be privatized, the methods of privatization, as well as priorities, are country-specific. They depend inter alia on the government's objectives, the sectors and enterprises which are most in need of new investments and efficiency improvements, and a number of factors which affect the design, implementation and outcomes of privatization programmes. These factors fall into two categories. One relates to the nature of the market into which the enterprise will be divested, i.e. whether it is competitive or non-competitive. The other set of factors concerns the conditions in the country concerned, including its overall macroeconomic policy framework (i.e. whether it is "market friendly" or not), its legal framework and regulatory and supervisory capacity, the size of its private sector, the availability of managerial and entrepreneurial skills, the level of development of its financial institutions and capital markets, the level of interest of external investors, and its political and social conditions.

11. In a favourable country environment, the divestiture of an enterprise in a competitive sector may require no more than adequate attention to transparency in the transaction, plus the removal of any inappropriate regulation or price controls. In the case of non-competitive sectors, the divestiture of an enterprise will need to be preceded by the establishment of a regulatory system to protect consumer welfare and the public interest. For many high- and middle-income countries, this can be done without much difficulty given their regulatory and supervisory capacity.

12. However, in an unfavourable country setting, with low regulatory capacity, major difficulties may arise, particularly with the transfer of ownership in non-competitive sectors. Experience suggests that countries in such situations may find it appropriate to start with small-scale sales and transfer of management arrangements for large-scale enterprises, such as management contracts, leasing and operating concessions, together with the establishment of an appropriate regulatory framework to promote competition and to safeguard consumer welfare. Such measures can serve as useful preparatory steps to ownership transfers.

13. In the countries undergoing the process of transition to a market economy, mass privatization is under consideration or has been launched. This could take several forms: transferring ownership to the existing managers and workers; turning enterprises into joint stock companies and distributing a percentage of shares to existing managers and workers; creating mutual funds cum holding companies, and distributing their shares to the public; distributing to the

public vouchers or coupons that entitle them to bid directly for shares in individual firms - and several variations thereof.

14. Against this background, the questions that may be addressed include:

(a) What has been the impact of privatization in terms of scale and efficiency gains in both competitive and non-competitive markets?

(b) What are the major factors which have influenced the formulation and implementation of privatization policies and programmes, including the scale, pace, sequencing and methods of privatization, as well as the selection of enterprises for privatization?

(c) Under what circumstances would the reform or rationalization of public enterprises be a necessary preparatory step to privatization?

(d) What role should the State play in enterprise development and in privatization? What instruments have been used for the development of the private sector, for the promotion of the efficiency of public enterprises and for the implementation of privatization?

(e) What lessons may be drawn from privatizations which have failed?

III. SOME SELECTED ISSUES OF PRIVATIZATION

A. Techniques for privatization

15. Once it has been decided to proceed with the privatization of an enterprise, a series of measures need to be taken. These include: (i) formulation of the preparatory action to be taken in advance of the privatization (whether the privatization should be preceded by restructuring of the enterprise, new investments, writing down of the enterprise liabilities, etc.); (ii) choice of the selling or transfer techniques to be adopted (private sales, public auctions, public share offerings, liquidation followed by sale of assets, direct negotiations, competitive bidding, joint ventures, sale of a core shareholding to a strategic investor, voucher or other schemes etc.); (iii) evaluation of the selling price (determination of a market-based price through competitive bidding, asset valuation as a benchmark, determination of the unit share price etc.); (iv) identification of any particular conditions to be attached to the sale (performance requirements, protection of employment during a specified period, retention of a "golden" or priority share for the Government, etc.); (v) identification of any particular issues raised because of the nature of the enterprise, as in the case of natural monopolies or public utilities (avoidance of the concentration of market power, environmental protection, etc.); and (vi) formulation of a public relations or marketing strategy (promotion of transparency of the privatization transaction; public explanation of the costs and benefits of privatization, etc.).

B. The financing of privatization 2/

16. While sales for cash are preferable to debt, public offerings often do not achieve their targets owing to weak financial systems. Some Governments have further constrained the sales market by excluding or favouring certain social groups or placing restrictions on the participation of institutional investors, financial institutions or foreign investors. Countries have also resorted to government credit to finance sales, because financial systems are not strong enough, the enterprises concerned are not sufficiently attractive and the preferred buyers do not have the necessary funds. Ways to ease financing constraints may be needed in order to avoid the extensive use of debt or highly-leveraged sales. Debt/equity swaps can ease financing constraints and help to improve a country's investment climate, but their use needs to be weighed against the alternative of selling the asset and using the proceeds to buy back debt on the market. The massive transfer of public assets to the population at large as a means of easing financial constraints has been undertaken in countries undergoing the process of transition to a market economy. Private sector financing through Build-Operate-Transfer (BOT) arrangements can provide another source of investment finance for infrastructure development. Where perceptions of country risk are high, some assistance from international agencies and bilateral donors in gaining access to financial markets may be needed.

C. Legal aspects of privatization

17. Existing legislation, as well as the legal status of the enterprises to be divested, must be analysed in order to determine whether they allow privatization and are consistent with the Government's objectives, or whether they need to be amended. Laws may need to be enacted to abolish a monopoly, regulate or deregulate the sector concerned, strengthen the country's capital markets, authorize the transfer of the enterprise to the private sector or organize the privatization process itself. Such laws can also influence the decisions of foreign investors. This is an important consideration where external capital is needed for the privatization of large-scale enterprises. Where the legal status of an enterprise does not allow or facilitate privatization, a change in the status will be required (e.g. corporatization). If the ownership of assets is disputed, the rights of contending parties must be clarified and an efficient judiciary system ensuring effective legal enforcement is needed. During the implementation stage, legal issues including the avoidance of conflicts of interest and the treatment of the enterprise creditors' rights will need to be addressed. Following completion of the privatization transaction, legal safeguards are required in order to ensure compliance with the terms of the privatization agreements. The regulatory framework may also have to be adjusted to allow the private enterprise to develop, while safeguarding consumer welfare and the public interest.

D. Support measures

18. Another set of issues relates to the design of privatization programmes in order to minimize any adverse social impact. This concerns the support measures

that are needed and their financing. Such measures may include retraining programmes coupled with employment creation, severance packages, financial incentives for the creation of small and medium-sized enterprises, unemployment insurance and other elements of the social safety net.

E. Institutional arrangements

19. Institutional arrangements will need to be established for the planning, negotiating, implementation and monitoring of privatization arrangements. While policy responsibilities for privatization will need to be vested in a central authority with a clear mandate, sufficient autonomy, and ready access to top decision-makers, implementation tasks may be decentralized to other entities operating under the supervision of the central authority. Certain procedures and criteria may have to be established for evaluating the performance and results of privatization programmes, including their political, economic and social dimensions.

F. Regulation, competition and privatization

20. The privatization of public utilities and services in non-competitive markets, such as telecommunications and power, raises questions concerning the relationship of regulation, competition and ownership. They include questions concerning the desirability of change of ownership where there is no possibility to achieve market competition; the relative impact on efficiency gains of effective competition, regulatory reforms and privatization; the role of competition policy in separating natural monopoly activities (e.g. basic communications services) from activities (e.g. sale of user equipment) where competition is possible; and the role of regulation in enhancing competition and in safeguarding consumer welfare where full or partial privatization is undertaken.

G. Possible issues for discussion

21. In the light of the above, the questions that may be addressed include:

(a) What are the techniques which have been used for privatization? What lessons may be drawn from them? What unforeseen issues have arisen and how have they been dealt with?

(b) What particular issues have been raised in specific sectors or areas, e.g. trade and trade-related services such as marketing and distribution, banking and insurance? What lessons may be learned from privatization programmes in such areas?

(c) What particular issues have been raised in the case of the privatization of "natural monopolies" or public enterprises which enjoy a monopolistic or oligopolistic market situation? Can preparatory action break up

monopolies or minimize their impact without substantial loss of efficiency and scale-economies? What safeguards have become necessary and which have been adopted?

(d) What has been the experience regarding the financing of privatization? What have been the respective roles of domestic financial institutions and capital markets and of foreign direct investment in the privatization process? What particular instruments have been used for the mobilization of both domestic and external resources and with what results? What has been the role of multilateral and bilateral financial institutions? What has been the contribution of privatization-led wider share ownership to domestic resource mobilization?

(e) What legal issues have been raised in the preparation, implementation and follow-up of the privatization process? What legal instruments have had to be enacted? Given the time-consuming process of enacting laws, how has that process affected the timetable for privatization?

(f) How have privatization programmes been designed in order to minimize their adverse social impact? What support measures have been used and how have they been financed?

(g) What institutional arrangements and institutions have been established for the planning, negotiating, implementation and monitoring of privatization? What lessons may be drawn from such arrangements and institutions, particularly as regards the centralization or decentralization of privatization policy responsibilites and implementation tasks?

(h) What procedures and criteria have been used for monitoring and evaluating the performance and results of privatization programmes? What weight has been given to political and social considerations, in addition to economic ones?

(i) How important are change of ownership, the strength of competitive forces and the quality of government regulation as factors in achieving efficiency gains? What functions does competition policy fulfil in the privatization process?

IV. ORGANIZATION OF WORK

22. In line with the terms of reference, and in order to take into account the diversity of country situations and experiences, the method of work of the Working Group should be based on active participation of national experts from developed countries, countries undergoing the process of transition to a market economy and developing countries at different levels of development, as well as the participation of representatives of international institutions, private enterprises, trade unions, the academic community, business associations and other non-governmental organizations. This broad-based participation of experts will be instrumental in the successful outcome of the work of the Working Group.

23. In establishing its work programme, the Working Group would need to take decisions at its first session involving:

- drawing up of priorities among the issues to be addressed;

- timing of future sessions;

- sequencing of the supporting work of the secretariat;

- requests for inputs from national experts, non-governmental actors, and representatives of international institutions;

- outlines of country studies for comparative analysis;

- arrangements for the presentation of national plans and programmes for privatization (see para. 5 of the terms of reference);

- identification of areas in which technical cooperation should be strengthened (see para. 8 of the terms of reference); and

- possible setting up of experts groups.

24. With regard to the latter, it will be recalled that, while the duration of the Working Group is limited to two years, the issues to be examined are numerous and some of them highly technical. Some of the issues mentioned above - for example privatization techniques or privatization results and their evaluation - would lend themselves to detailed examination by expert groups, whose establishment could be recommended for the consideration of the Board.

25. In order to expedite its work, the Working Group may wish to devote its first session not only to organizational but also to substantive matters. For example, a preliminary discussion of the issues raised in this paper would help the Working Group in drawing up its work programme and setting its priorities.

Notes

1/ Privatization: The lessons of experience, World Bank, Country Economics Department, April 1992.

2/ In addressing this topic, the Working Group would benefit from the activities of the Ad Hoc Working Group on Investment and Financial Flows; Non-debt-creating Finance for Development: New Mechanisms for Increasing Investment and Financial Flows, the first session of which is to be held from 9 to 13 November 1992.